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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
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In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996:	)	
	)	CC Docket No. 96-150
Accounting Safeguards Under the	)	
Telecommunications Act of 1996:	)	

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COMMENTS OF SBC COMMUNICATIONS INC.

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CC Docket No. 96-150

TABLE OF CONTENTS

SUMMARY[*]

As the Commission proceeds with this NPRM, it must consider any proposed action against the procompetitive, deregulatory backdrop of the 1996 Act, which undeniably seeks to minimize the burden of regulation and to reduce or eliminate any regulation that would impede or impair the benefits of competition. Sections 260 and 271 through 275 of the 1996 Act do not direct the Commission to adopt any new LEC accounting safeguards for telemessaging, interLATA, manufacturing, alarm monitoring and payphone activities. Instead, these provisions of the 1996 Act seek to prevent cross-subsidy of these LEC activities by regulated service ratepayers. The 1996 Act does not specify what regulatory mechanism should be used to prevent such cross-subsidy. In view of the deregulatory intent of the 1996 Act, price cap regulation and other forms of incentive regulation are more than sufficient as safeguards against cross-subsidy. Protection of competitors or competition also does not justify imposition of accounting safeguards.

If the Commission, out of an abundance of caution, decides to continue to apply its cost allocation and affiliate transaction rules even though they are not necessary under price cap regulation and other forms of incentive regulation, the existing rules are more than sufficient to accomplish the objectives of the 1996 Act. However, the Commission should consider changes to streamline the accounting safeguards, such as those being suggested by USTA in its Comments.

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[*] All abbreviations used herein are referenced with the text.

Existing Part 64 cost allocation rules are more than sufficient to satisfy the 1996 Act's requirements relating to integrated provision of new services. In fact, it is not necessary to make any change at all in the cost allocation rules for incidental interLATA services because the activities they support will be subject to the existing cost allocation rules. Besides being unnecessary, the NPRM's two suggested special cost allocation rules for incidental interLATA services would constitute a fundamentally different approach to cost allocation and would be extremely burdensome and disruptive.

The 1996 Act also does not require any additional or more stringent affiliate transaction rules. The existing affiliate transaction rules are more than sufficient to assure that interLATA, manufacturing, electronic publishing and other activities required or permitted to be conducted through separated operations are not subsidized at the expense of ratepayers of regulated services. It is beyond comprehension why the Commission wishes to eliminate the prevailing price valuation method. If a tariffed rate is still a valid method for affiliate services, then it is unclear why a generally available price established in transactions "at arm's length" between willing buyers and willing sellers should not also continue to be a valid method. Given the procompetitive goals of the 1996 Act, it would be entirely consistent to allow LEC affiliate sales to be recorded at prices determined by that competitive market. Elimination of prevailing price forces the valuation process into the more cumbersome tier of determining fully distributed cost. There is no justification to impose this additional regulatory burden when the existing rules provide a reliable method of determining the value of the affiliate transaction.

On the one hand, the NPRM proposes to eliminate an objective method that is based on actual transactions involving the same services provided by the same affiliate, and on the other, the NPRM proposes to superimpose a subjective determination of fair market value presumably based upon a review of reasonably comparable transactions (if any are available) between wholly unrelated parties. The Commission should not eliminate the objective prevailing price test, nor should it make its regulations more intrusive by the addition of the subjective estimated fair market value test.

The Commission should stick to its original position adopted in CC Docket No. 86-111 that a fair market value test is not appropriate for services. As the Commission concluded in CC Docket No. 86-111, the adoption of an estimated fair market value test for services "is fraught with the potential for abuse, and would be difficult to monitor." The adoption of a fair market value test for services will degrade the clarity of current rules at a time when clarity is all the more important. The NPRM's proposal will result in endless discussion of what constitutes the fair market value for a multitude of services, including shared administrative services. The costs incurred in performing such valuations cannot be justified by the minimal theoretical benefits the Commission hopes to obtain.

The Commission need not adopt any other detailed, intrusive or onerous affiliate rules. For transactions between a BOC and its interLATA affilate, the existing affiliate transaction rules are also more than sufficient. The Commission should not adopt unnecessarily detailed filing or disclosure requirements for information relating to affiliate transactions or the Section 274 separated affiliates.

The Commission should not impose any accounting requirements other than GAAP on the BOCs' interLATA affiliates. The Commission has not found it necessary to impose any such requirements on other interLATA carriers, and thus it is clear that subscribers of interLATA carriers do not require protection from cross-subsidy.

These and other onerous or intrusive regulations are not required by the 1996 Act and are not justified in the current competitive and regulatory environment.

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COMMENTS OF SBC COMMUNICATIONS INC.[1]

As a result of the Telecommunications Act of 1996[2] (the "1996 Act"), the Bell Operating Companies ("BOCs") and/or their affiliates are, or will be, permitted to engage in interLATA and manufacturing activities that were previously prohibited. Their participation in these and certain other competitive markets are subject to certain conditions and requirements contained in Sections 260 and 271 through 276 of the 1996 Act.[3] In the Notice of Proposed Rulemaking ("NPRM")[4] herein, the Commission seeks comments on these 1996 Act conditions and requirements from the accounting and policy perspective of the Part 64 cost allocation rules[5]

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[1] SBC Communications Inc. ("SBC") files these Comments by its attorneys and on behalf of its subsidiaries, including Southwestern Bell Telephone Company ("SWBT"), Southwestern Bell Communications Services, Inc. ("SBCS"), and Southwestern Bell Mobile Systems, Inc. ("SBMS"), in response to the Commission's Notice of Proposed Rulemaking released on July 18, 1996 ("NPRM"). SBC also adopts and supports the comments of United States Telephone Association ("USTA") being filed in this proceeding.

[2] Pub.L.No. 104-104, 110 Stat. 56 (1996) to be codified at 47 U.S.C. §§151 et seq. All references herein to the 1996 Act will use the sections of Title 47 at which they will be codified.

[3] 47 U.S.C. §§260, 271-276.

[4] FCC 96-309, released July 18, 1996.

[5] 47 C.F.R. §§64.901 et seq.

applicable to integrated operations and the Part 32 affiliate transaction rules[6] applicable to separated operations. In these Comments, SBC responds to these inquiries and concurs with the NPRM's approach to the extent it is consistent with "decompartmentalizing segments of the telecommunications industry, opening the floodgates of competition through deregulation and most importantly, giving consumers choice ."[7] However, the Commission should not impose a more detailed or onerous set of accounting safeguards not required by the 1996 Act. If Congress had intended for the Commission to increase the burden of the Commission's accounting regulations, it would have written additional requirements into Sections 260 and 271 through 276 of the 1996 Act.

I. CONSISTENT WITH THE 1996 ACT, THE COMMISSION SHOULD MINIMIZE THE BURDEN OF ITS REGULATIONS.

As the Commission proceeds with this and other interrelated rulemakings,[8] it must consider any proposed action against the procompetitive, deregulatory backdrop of the 1996 Act. From the preamble and throughout many of its provisions, avoidance of unnecessary regulation and encouragement of robust competition are pervasive themes, both express and implied. Instead of prescribing a regulatory national policy framework, the 1996 Act seeks to establish a "de-regulatory national policy framework." This deregulatory intent is most explicit in Title IV

[6] 47 C.F.R. §32.27.

[7] NPRM, n. 5 (quoting 142 Cong. Rec. H1149 (statement of Rep. Fields)).

[8] The two most closely interrelated rulemakings were initiated at the same time as this NPRM. See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 as Amended, CC Docket No. 96-149, Notice of Proposed Rulemaking FCC 96-308, released July 18, 1996 ("BOC In-Region Non-Accounting NPRM"); Implementation of the Telecommunications Act of 1996: Telemessaging, Electronic Publishing, and Alarm Monitoring Services, CC Docket No. 96-152, Notice of Proposed Rulemaking, FCC 96-310, released July 18, 1996 ("Electronic Publishing NPRM").

of the 1996 Act, entitled "Regulatory Reform," which requires the Commission to forbear from applying unnecessary regulation.[9] It also requires the Commission to conduct a biennial review of all of its regulations to determine whether they are still necessary in the public interest "as a result of meaningful economic competition between providers of such service."[10] This procompetitive, deregulatory intent is also reflected throughout the legislative history of the 1996 Act, such as the following statements by Senator Pressler:

> Yet as the United States stands at this critical crossroads - the dawn of a new era in high technology, entertainment, information and telecommunications - America continues to operate under an antiquated regulatory regime. Our current regulatory scheme in America simply does not take many dramatic technological changes into account.
>
> Progress is being stymied by a morass of regulatory barriers which balkanize the telecommunications industry into protective enclaves. We need to devise a new national policy framework - a new regulatory paradigm for telecommunications - which accommodates and accelerates technological change and innovation.
>
> ...
>
> We can no longer keep trying to fit everything into the old traditional regulatory boxes - unless we want to incur unacceptable economic costs, competitiveness losses, and deny American consumers access to the latest products and services.
>
> ...
>
> It is time for American policy makers to meet this new challenge much the way an earlier generation responded when the Russians launched Sputnik. The response must be rooted in the American tradition of free enterprise, de-regulation, competition, and open markets - to let technology follow or create new markets, rather than Government micro managing and stunting development in telecommunications and information technology.[11]

The 1996 Act undeniably seeks to minimize the burden of regulation and to reduce or eliminate any regulation that would impede or impair the benefits of competition. While the

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[9] Pub. L. No. 104-104, 110 Stat. 56, §§401, 402 (1996) to be codified at 47 U.S.C. §§10, 11.

[10] 47 U.S.C. §11.

[11] 141 Cong. Rec. At S7885-7886 (June 7, 1995).

NPRM recognizes in principle the deregulatory objectives of the 1996 Act, it does not propose to reduce or eliminate unnecessary accounting regulation as sought by the 1996 Act. For example, the NPRM states that "we continue to seek to minimize the burden our rules impose upon those subject to them,"[12] but the NPRM does not eliminate or reduce any of the cost allocation or affiliate transaction rules. Instead, the NPRM suggests certain unnecessary rule changes that would increase the burden of regulation and serve as a disincentive to achieving the benefits resulting from economies of scope. Among other examples, the proposals to eliminate the prevailing price method and to require estimates of fair market value for numerous affiliate services is more onerous regulation than before the 1996 Act.

Sections 260 and 271 through 275 of the 1996 Act do not direct the Commission to adopt any new LEC accounting safeguards for telemessaging, interLATA, manufacturing, alarm monitoring and payphones. Instead, these provisions of the 1996 Act seek to prevent cross-subsidy of these LEC activities by regulated service ratepayers. The 1996 Act does not specify what regulatory mechanism should be used to prevent such cross-subsidy. Certainly the 1996 Act could not be construed to require that accounting safeguards now in existence must continue to be applied, if there is a less onerous alternative that is just as effective in preventing cross-subsidy. SBC submits that in view of the deregulatory intent of the 1996 Act, price cap regulation and other forms of incentive regulation are more than sufficient as a safeguard against cross-subsidy.

If the Commission applies the standard for reducing or eliminating unnecessary regulation to the subjects of this NPRM, it should conclude that accounting safeguards other than

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[12] NPRM, ¶8.

such price regulation are not necessary to protect regulated service ratepayers against cross-subsidy or to assure that competition in telecommunications markets is not adversely affected. The regulations adopted as a result of this NPRM should be narrowly tailored to accomplish only that which the 1996 Act expressly requires. At most, the Commission should merely rely on the existing accounting safeguards.

II. ACCOUNTING SAFEGUARDS ARE NOT NECESSARY TO PROTECT RATEPAYERS OF LECS NOT SUBJECT TO RATE-OF-RETURN REGULATION OR SHARING OBLIGATIONS.

The NPRM recognizes that Congress' intent in seeking to deter cross-subsidy of competitive activities at the expense of regulated service subscribers, as reflected in Sections 260 and 271 through 276, "was to protect subscribers to these services from increased rates."[13] Because price cap regulation and other forms of incentive regulation protect subscribers against increased rates, they fulfill the role that Part 64 cost allocation rules have served in preventing cross-subsidy.[14]

The NPRM asks for commenters' help to determine the best way to fulfill Congress' intent of protecting regulated service ratepayers against rate increases.[15] The NPRM also asks for comment on the need to continue applying Part 64 cost allocation rules to price cap LECs in

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[13] NPRM, ¶14.

[14] See In the Matter of Separation of costs of regulated telephone service from costs of nonregulated activities, Amendment of Part 31, the Uniform, System, of Accounts for Class A and Class B Telephone Companies to provide for nonregulated activities and to provide for transactions between telephone companies and their affiliates. CC Docket No. 86-111, 2 FCC Rcd 1298 ¶37 (1987) ("Joint Cost Order"), recon., 2 FCC Rcd 6283 (1987) ("Joint Cost Recon Order"), further recon., 3 FCC Rcd 6701 (1988) ("[P]rotecting ratepayers from unjust and unreasonable interstate rates is the primary purpose behind the accounting separation of regulated from nonregulated activities."); Joint Cost Recon Order, ¶ 142.

[15] NPRM, ¶14.

the event price cap regulation were amended to permanently eliminate sharing obligations.[16] Based on the express intent of the 1996 Act described above and as acknowledged in the NPRM, the best way to fulfill that intent is to rely on price cap regulation - - at least for price cap LECs that are not subject to sharing obligations. Under these circumstances, detailed, intrusive or financially restrictive cost allocation rules are not required. Price cap regulation or other forms of price regulation, such as price freezes, are sufficient to ensure that customers are protected from price increases.

The NPRM correctly recognizes that if the benefits of integrated operations are to be realized, the Commission must refrain from trying to "capture" the financial benefits of economies of scope through newly crafted cost allocation rules.[17] It is due to the existence of these economies of scope, together with the demands of customers, that telecommunications carriers provide broad ranges of telecommunications services. As a result, consumers benefit from the integrated provision of services.

Price regulation does not and should not require cost allocations among services, whether they are highly competitive services or services where the carrier retains some market power and price regulation is required. It is the existence of the overall price cap limit itself that protects customers from price increases. The addition of detailed cost allocation requirements does not improve this customer safeguard.[18]

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[16] Id., ¶124.

[17] Id., ¶7.

[18] The Commission has long relied on the need to break the tie between the price of services and the cost allocations for specific services or groups of services. See, e.g., Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6791 ¶35 (1990) ("LEC Price Cap Order"); Price Cap Performance

Price cap regulation without sharing obligations and other forms of incentive regulation sever the link between cost allocations and prices. As a result, cost allocation is irrelevant to the prevention of cross-subsidy at the expense of regulated services.

III. COST ALLOCATION WOULD HAVE NO EFFECT ON A TOTAL FACTOR PRODUCTIVITY OFFSET.

The NPRM suggests that even price cap LECs may have an incentive to misallocate costs to regulated activities in anticipation of "price caps that may be adjusted in the future."[19] While the NPRM never explains this concern, this appears to be the same issue that was raised by commenters in response to the Video Cost Allocation NPRM in CC Docket No. 96-112.[20] There, several LECs pointed out that price caps without sharing avoids the necessity of cost allocation to prevent cross-subsidy.[21] Some commenters, scrambling to find a new justification for continuing to require LECs to follow burdensome cost allocation rules, argued that even if sharing were permanently eliminated, LECs would still have an incentive to cross-subsidize in view of the alleged potential effect on the productivity factor and future periodic reviews of price cap plans.[22]

Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961, 9002-03, 9045 (1995); Price Cap Performance Review for AT&T, CC Docket No. 92-134, Report, 8 FCC Rcd 6968 ¶ 3 (1993).

[19] NPRM, ¶6.

[20] Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112, Notice of Proposed Rulemaking, FCC No. 96-214, released May 10, 1996 ("Video Cost Allocation NPRM").

[21] See, e.g., Ameritech Comments, CC Docket No. 96-112, May 31, 1996, at 5.

[22] See, e.g., New England Cable Television Association Reply Comments at 13-14; TCI Reply Comments at 4-5; Time Warner Reply Comments at 2, CC Docket No. 96-112, filed June 12, 1996.

Concerning productivity, one commenter argued that price caps would not solve the cross-subsidy problem "because the price cap index imperfectly captures the LEC's productivity growth"[23] and that "by shifting costs from nonregulated to regulated services, a LEC can lower its productivity resulting in a reduced productivity factor in future years."[24] This concern, however, is unfounded, at least as it relates to the measurement of productivity recommended by SWBT, USTA and other price cap LECs in CC Docket No. 94-1. USTA proposed a total factor productivity measurement developed by Dr. Laurits R. Christensen of Christensen Associates.

This total factor productivity measurement, described in the USTA ex parte presentation attached as Exhibit "A", utilizes total company operations based on the Commission's definitions embodied in Part 32 accounting rules, before any allocations of costs to nonregulated operations.[25] For this reason, any changes in cost allocation rules that might be considered by the Commission (be they Part 64, Part 36, or Part 69 cost allocations) have absolutely no effect on measured productivity results. By design, all productivity gains, including achievement of economies of scope from nonregulated operations, are included in the productivity measurement. Any cost allocation rules would not increase or decrease the assignment of productivity gains to regulated customers. In fact, ad hoc attempts to use cost allocation rules to assign productivity gains to jurisdictions or groups of customers would be arbitrary and inaccurate because they would be based on predetermined, result-oriented illogic. In addition, they would result in some

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[23] Cox Reply Comments, CC Docket No. 96-112, June 12, 1996, at 3.

[24] Cox Comments, CC Docket No. 96-112, May 31, 1996, at 11.

[25] See "Treatment of LEC Investment in Joint-Use Broadband Facilities Under a Price Cap Regime," by Dr. Laurits R. Christensen, filed with a letter from Keith Townsend, USTA, to William Caton, in CC Docket No. 96-112, on July 17, 1996 ("Christensen").

double-counting if they are intended to allocate (or over-allocate) benefits that are already factored into the total factor productivity measure applied to regulated prices.

Thus, if the provision of incidental interLATA services by LECs using integrated networks leads to the achievement of economies of scope, the moving average productivity offset (proposed by SWBT and supported by the Commission in the Fourth Further Notice of Proposed Rulemaking in CC Docket No. 94-1)[26] would pick up that productivity improvement. As a result, customers of regulated services would experience the financial benefits of economies of scope.

While regulated costs may need to be identified by some LECs pursuant to a Part 64 cost allocation process for some limited or special future purposes to be addressed in other proceedings under the 1996 Act,[27] such process is not needed to fulfill the intent of Congress in Sections 260 and 271 through 276 to protect ratepayers of price cap LECs' regulated service against increased rates to cross-subsidize these competitive ventures.

If the Commission, out of an abundance of caution, decides to continue to apply its cost allocation and affiliate transaction rules even though they are not necessary under price cap regulation and other forms of incentive regulation, SBC explains below why existing rules are more than sufficient to accomplish the objectives of the 1996 Act.

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[26] See Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Fourth Further Notice of Proposed Rulemaking, 10 FCC Rcd 13659 ¶¶22-25, 96 (1995).

[27] See SWBT Reply Comments, CC Docket No. 96-112, filed June 12, 1996, at 9; SWBT Comments, New England Telephone and Telegraph Company and New York Telephone Company Petition for Forbearance from Jurisdictional Separations Rules, AAD 96-66, filed August 5, 1996 at 2-3.

IV. ACCOUNTING SAFEGUARDS ARE NOT NECESSARY TO PROTECT COMPETITORS OR TO PREVENT ADVERSE EFFECT ON COMPETITION.

The NPRM states that accounting safeguards are intended to serve two general purposes: first, protecting ratepayers from the cross-subsidy of increased rates -- which we have discussed above -- and second, to protect the LECs' competitors against discrimination.[28] Protection of competitors against discrimination would be a new purpose for accounting safeguards such as Part 64. It was not the purpose of Part 64 cost allocation rules adopted in 1987 in the Joint Cost Order. In fact, in response to suggestions that the cost allocation rules should be used to pursue the goal of protecting competition by assuring that nonregulated prices are not too low, the Commission disclaimed any intention of extending its regulation to "protect competition" in these nonregulated markets.[29]

In any event, the 1996 Act does not require the Commission to expand the purposes of the accounting safeguards to include protection of competition, and it certainly could not be construed to require the Commission to protect competitors in competitive markets against effective competition by BOCs and other LECs. On the contrary, as demonstrated previously, Congress intended to open the floodgates of competition and to rely on competition, not regulation, in competitive markets. The NPRM reaches the same conclusion when it states that Congress' "primary intent" was to protect regulated ratepayers from increased prices.[30] The Commission should disclaim any intention of using the accounting safeguards as a method of indirectly attempting to regulate competitive markets. For example, the NPRM states that one of

[28] NPRM, ¶¶4, 8, 11.

[29] Joint Cost Order, ¶40.

[30] NPRM, ¶14.

the purposes of the accounting safeguards is to "prevent carriers from using their existing market power in local exchange services to obtain an anticompetitive advantage in those new markets the carriers seek to enter."[31] Nothing in the 1996 Act suggests that the Commission should use burdensome accounting rules to regulate new competitive markets. Protection of competitors from discrimination can be accomplished by less burdensome procedures, such as enforcement of the nondiscrimination provisions of the Communications Act through monitoring of discrimination, complaint procedures and other less regulatory means.

The 1996 Act does state that the Commission should assure that BOCs' entry into these new markets will not adversely affect competition, but it does not point the Commission to any specific method of doing so, and it certainly would be contrary to the 1996 Act's purposes to use a method which is more burdensome than necessary in the public interest. So long as regulated service ratepayers do not experience price increases caused by BOC entry into these new markets, competition would not be improperly affected.

V. PRICING IN COMPETITIVE MARKETS IS IRRELEVANT TO THIS PROCEEDING.

While the NPRM does not suggest any changes in existing accounting safeguards to attempt to protect competitors, the NPRM does discuss certain theoretical concerns regarding LEC pricing strategies and seeks "comment on the extent to which the opportunities to engage in predatory behavior should affect"[32] the Commission's decisions in this proceeding. Decisions concerning prices in competitive markets have no place in an accounting safeguards proceeding. The nondiscrimination requirements of the Communications Act, to the extent applicable, are

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[31] Id., ¶4.

[32] Id., ¶16.

more than sufficient protection against the types of theoretical discrimination against competitors, such as "price squeeze," described in paragraphs 15 and 16 of the NPRM.

Even if competitive pricing practices were a proper subject of accounting safeguards, which they are not, the Commission should conclude that any expansion of accounting safeguards for this purpose would be completely unnecessary and would constitute regulatory "over-kill", especially since LECs have neither the practical capability nor compelling incentives to attempt such anticompetitive pricing strategies.

There appear to be virtually no incentives for LECs to discriminate against rival interexchange carriers("IXCs"). Raising this concern, the Commission speculates that BOCs could establish lower access charges for their own interexchange affiliates or alternatively increase access prices paid by competing IXCs.[33] Despite being offered amid increasingly competitive market conditions, LEC carrier access prices remain bound by the tariff processes and nondiscrimination requirements controlled by both state regulators and the Commission. LEC access charges publicly posted in tariffs are equally available to all competing IXCs and LEC interLATA affiliates (via "arm's length" transactions). Obvious tariff violations such as a LEC providing its interLATA affiliate with an unfair competitive advantage by charging lower access prices than those paid by competitors would be immediately and clearly identified as illegal price discrimination subject to both regulatory and antitrust actions. Similarly, LECs have no incentives to intentionally degrade the quality of service provided to competitors since such attempts would not go undetected by regulators and rival IXCs. The assurance of failure of such actions and the potentially severe regulatory and antitrust remedies awaiting violators

[33] Id., ¶15.

should eliminate the Commission's concerns regarding any arguments that LECs could successfully pursue "price squeeze" strategies.[34]

Despite the NPRM's conjecture that "a carrier subject to rate-of-return regulation may have an incentive to engage in predatory pricing,"[35] there are no such clear economic incentives, as the Commission has observed previously.[36] The object of a predatory pricing campaign is for one firm to maintain prices below costs long enough to drive rivals from the market, then recover those financial losses plus reap anticompetitive profits by charging monopoly prices. First, one would have to assume that a LEC could satisfy the essential prerequisite that it have the financial resources to sustain the enormous losses required to drive numerous IXCs from the market -- an assumption which is highly suspect. Further, increasingly competitive conditions in intrastate toll, access, and local exchange markets, coupled with regulators' resistance to local service price increases, effectively eliminate cross-subsidy as a method for financing a LEC predatory pricing strategy. Thus, current regulation prevents the necessary recoupment phase of a successful predatory pricing strategy. In addition, as correctly recognized by the Commission,

[34] See id., ¶15. In addition, the Commission's price cap system provides several safeguards against a price squeeze. See, Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, Second Further Notice of Proposed Rulemaking, 11 FCC Rcd 858, 869 ¶19 (1995).

[35] NPRM, ¶16.

[36] Revisions to Price Cap Rules for AT&T, CC Docket No. 93-197, Further Notice of Proposed Rulemaking, 10 FCC Rcd 7854 ¶45 (1995) ("successful predation . . . is an unlikely occurrence."); Price Cap Performance Review for Local Exchange Carriers, CC Docket No. 94-1, First Report and Order, 10 FCC Rcd 8961 ¶409 (1995) ("We do not believe that a limited increase in downward pricing flexibility would significantly increase the risk of successful predation by the LECs. As we concluded in the LEC Price Cap Order, predatory pricing is fairly uncommon, proven cases are rare, and the establishment of price cap baskets 'lessens the already unlikely occurrence of predation.'").

even if rivals are driven from the long distance market, the relevant production capacity (i.e., the network facilities) remains to be purchased and operated by other firms seeking to share in any profits produced by an apparently successful predatory pricing strategy.[37] Such entrants can be expected to quickly reduce profit margins to "normal" competitive levels, leaving the firm that attempted the predatory pricing with substantial unrecovered losses. Since there is no realistic chance of success, speculation about predatory pricing should not have any part in this or any other proceeding to implement the provisions of the 1996 Act.

VI. EXISTING PART 64 RULES ARE MORE THAN SUFFICIENT TO SATISFY THE REQUIREMENTS AND GOALS OF THE 1996 ACT.

The Commission tentatively concludes that "existing Part 64 cost allocation rules generally satisfy the statute's requirement of safeguards to ensure that these services are not subsidized by subscribers to regulated telecommunications services."[38] SBC agrees that the 1996 Act does not require adoption of additional, more detailed cost allocation rules. In fact, the 1996 Act requires that the Commission retain only the minimum cost allocation rules reasonably necessary in the public interest.[39] In view of price cap regulation and competition, Part 64 cost allocation rules are not necessary to prevent cross-subsidy at the expense of ratepayers of price cap LECs. For LECs not subject to rate-of-return regulation or sharing obligations, existing Part 64 cost allocation rules already provide a redundant safeguard against such cross-subsidy and

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[37] Id., ¶16.

[38] NPRM, ¶ 27.

[39] See 47 U.S.C. §§10, 11.

provide more protection than is necessary against true economic cross-subsidy.[40] To the extent Part 64 is retained as a redundant safeguard against cross-subsidy, the Commission certainly should not adopt more stringent or detailed cost allocation rules. Further, SBC supports USTA's position in this proceeding which advocates adoption of specific rule changes to streamline these accounting safeguards. Therefore, consistent with the 1996 Act, the Commission's action on this NPRM, at its most regulatory, should continue to rely on existing Part 64 cost allocation rules.

A. The 1996 Act Does Not Require Additional Cost Allocation Rules.

The Commission examines certain sections of the 1996 Act that relate to services that LECs may offer on an integrated basis, including telemessaging, alarm monitoring, payphone and interLATA services. The Commission tentatively concludes that existing Part 64 cost allocation rules generally satisfy the 1996 Act's requirements relating to integrated provision of these services. It is consistent with this tentative conclusion that these sections of the 1996 Act do not require the Commission to adopt any new or revised cost allocation rules. In fact, these sections merely contemplate that, in the event of cross-subsidy or discrimination, the Commission has authority to deal with such conduct through a complaint process.[41]

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[40] Declaration of Dr. Alfred E. Kahn, Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services, CC Docket No. 96-112, filed July 19, Affidavit of William E. Taylor attached to SNET Comments, CC Docket No. 96-112, filed May 31, 1996.

[41] See SBC Comments, CC Docket 96-149, filed August 15, 1996, at 7. The Commission is considering the procedural rules for such complaints in CC Docket No. 96-152. See Electronic Publishing NPRM, ¶¶ 81-84. Cf. Policies and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, Notice of Proposed Rulemaking, 11 FCC Rcd 7141, 7178 ¶ 70, 7182 ¶ 78 (1996) (proposing to allow complaint process to address rate averaging and rate integration requirements of the 1996 Act).

1. Telemessaging/Alarm Monitoring

Section 260 of the 1996 Act requires the Commission to establish procedures for cross-subsidy or discrimination complaints filed against LECs by telemessaging service providers, but it does not require adoption of any cost allocation rules or accounting safeguards. The following legislative history also reflects that Section 260 only requires adoption of procedural, and not substantive, rules:

> This section requires the Commission to establish procedures or regulations thereunder for the expedited receipt and review of complaints alleging discrimination or cross-subsidization that result in material financial harm to providers of telemessaging services. Such procedures shall ensure that the Commission makes a determination regarding any such complaint within 120 days.[42]

Section 275, concerning alarm monitoring, contains much the same language relating to cross-subsidy as Section 260. As with telemessaging, the 1996 Act only requires the Commission to adopt procedures for processing discrimination or cross-subsidy complaints against LECs.[43] Thus, no additional cost allocation rules are needed to implement the 1996 Act's requirements regarding alarm monitoring services.[44]

2. Payphone

With respect to payphones, Section 276(b)(1)(C) indicates that the Commission must use nonstructural safeguards "at a minimum . . . equal to those adopted in the Computer

[42] Conference Report 104-458, 104th Cong., 2d Session, February 1, 1996, at 138.

[43] 47 U.S.C. § 275(c).

[44] SWBT concurs with USTA's Comments concerning the efficacy of the existing safeguards to meet the requirements of Section 273(d) relating to certifying entities.

Inquiry III (CC Docket No. 90-623) proceeding."[45] The Part 64 cost allocation rules were adopted as accounting safeguards to implement Computer Inquiry III.[46] Thus, existing Part 64 cost allocation rules are exactly what Congress expressly contemplated as the accounting method to be used in implementing the transfer of payphones from regulated to nonregulated status. Further, these safeguards are more than sufficient to protect against cross-subsidy of the ongoing payphone operations. Section 276 does not require the Commission to adopt more stringent cost allocation rules than the Part 64 requirements.[47]

Given that the purpose of the nonstructural safeguards required by Section 276 is to move payphones to nonregulated status and to implement the requirement that BOCs "shall not subsidize its payphone service directly or indirectly from its [regulated] operations,"[48] price cap regulation can and should replace Part 64 as a sufficient nonstructural safeguard for price cap LECs. The Commission need not continue applying Part 64 cost allocation rules indefinitely, especially as they become even more unnecessary to provide protection against cross-subsidy. Neither Section 276 nor any other provision of the 1996 Act requires accounting

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[45] 47 U.S.C. § 276(b)(1)(C).

[46] Joint Cost Order, ¶29.

[47] See RBOC Coalition Comments, CC Docket No. 96-128, filed July 1, 1996 at 27-29 and attached paper by Carl Geppert, "Calculation of Per-Call Compensation and Review of Accounting and Regulatory Treatment for Payphone Asset Reclassification" at 12-18. Also, consistent with the RBOC Coalition Comments, the reclassification of payphone customer premises equipment ("CPE") should be accomplished based on past Commission treatment of CPE valuation at net book value.

[48] NPRM, ¶ 24; 47 U.S.C. § 276(a)(1).

safeguards to remain frozen.[49] Thus, as the Commission proceeds toward implementation of a permanent price cap plan, it also should consider forbearance from applying Part 64 cost allocation rules with respect to all nonregulated services, including payphones.

3. InterLATA Services

Under Section 271 of the 1996 Act, there are three categories of interLATA service: (1) out-of-region interLATA services; (2) incidental interLATA services; and (3) in-region interLATA services. Enactment of the 1996 Act gave BOCs immediate authority to begin providing the first two of these types of interLATA services and they can do so on an integrated basis. In-region interLATA services, on the other hand, must initially be provided by a separate affiliate in compliance with Section 272. In seeking comment on the cost allocation rules for integrated interLATA services, the NPRM is inquiring only about the rules applicable to incidental interLATA services and out-of-region interLATA services.

The 1996 Act did not require the Commission to adopt any new cost allocation rules for BOC entry into out-of-region and incidental interLATA services immediately after its enactment, nor does it require them now for any interLATA services. Section 271 merely states, with respect to incidental interLATA services, that "[t]he Commission shall ensure that the provision of services authorized under subsection (g) by a Bell operating company or its affiliate will not adversely affect telephone exchange service ratepayers or competition in any

[49] It is obvious that Congress did not intend for the Commission to adopt nonstructural safeguards identical to those originally adopted in Computer Inquiry III and to continue applying those safeguards indefinitely because the 1996 Act itself requires changes to some nonstructural safeguards, such as the CPNI rules. See 47 U.S.C. § 222.